

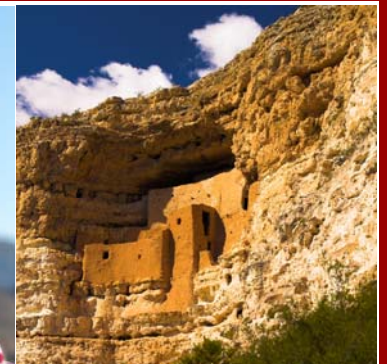
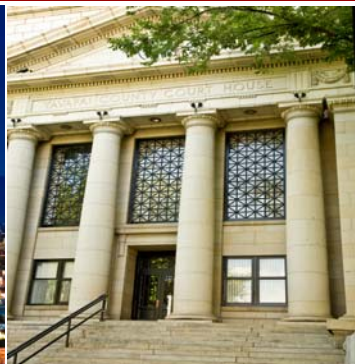
ARIZONA STATE RETIREMENT SYSTEM

Delivering Service With Pride



Popular Annual Financial Report

For Fiscal Year Ended June 30, 2012



AZ 100 YEARS
HISTORY. STILL IN THE MAKING.



2013 Board Meetings

January	25
February	22
March	22
April	26
May	24
June	28
August	23
September	27
October	25
November	22

Meetings begin at 8:30 a.m. in the ASRS Phoenix Board Room at 3300 N. Central Avenue, 10th Floor, unless otherwise posted. Schedule is subject to change. For Information please visit us at www.azasrs.gov.

Did You Know...

ASRS decreased administration costs by 3.2 percent per year between 2008 and 2011 while other governmental pension plans that are similar in size to the ASRS decreased administration costs by 0.8 percent in the same time frame.

The ASRS Total Pension Administration Cost was \$78 per member. This is \$11 below our peer average.

The ASRS had a lower cost per full-time employee than our peers while performing more transactions per member than our peers.

In compiling a comparable score for Total Service provided to members, the ASRS received a score of 80 out of 100, which is slightly better than our peer median of 79.

ASRS Board of Trustees

Fiscal Year 2011-2012



David Byers
Chair
Phoenix, State
Employees



Thomas Connelly
Vice Chair
Phoenix, Public



Christopher Harris
Phoenix, Public



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Phoenix, Educators



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Kevin McCarthy
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Public



Michael Townsend
Flagstaff, Political
Subdivisions



Lawrence Trachtenberg
Scottsdale,
Public



Steven Zeman
Phoenix, Retirees

ASRS Board Trustees are appointed to three-year terms by the governor and are confirmed by the Arizona State Senate. Four trustees of the Board must have a minimum of 10 years investment experience and each trustee who represents an ASRS member group shall have no less than five years of administrative management experience. There is no limit to the number of terms a Trustee may serve.

Message from the Director

To Our Members:

I am pleased to present the 2012 Popular Annual Financial Report for the Arizona State Retirement System for the fiscal year ended June 30, 2012.

The information presented here is a reader-friendly summary of the more detailed 2012 Comprehensive Annual Financial Report (CAFR), which is prepared and presented in conformity with Generally Accepted Accounting Principles. The Popular Report is not intended to supplement the CAFR; rather, it is a concise summary of the financial health, investment performance and key accomplishments of the ASRS throughout fiscal year 2012. Should you wish to review the more detailed CAFR, I encourage you to visit our website at <https://www.azasrs.gov/web/Publications.do> where you can find the report.

As we celebrate the 100th year of statehood this year, the ASRS continues to provide benefits to our state's public servants. We continue to closely monitor the health and stability of the programs and plans that provide retirement benefits, long-term disability coverage and retiree health insurance programs for our members. I am pleased to report that while facing challenges in today's economy, the viability of all our programs remains strong.

In fiscal year 2011-12, the ASRS paid in excess of \$2.45 billion in benefits to more than 117,000 retirees, beneficiaries and disabled members. Our overall membership decreased slightly from the previous year, although we still serve more than 535,000 members.

Among our major initiatives over the past year was a review and update of our Strategic Asset Allocation Policy, a critical document that sets the foundation for management of our total investment portfolio, which is currently approximately \$28 billion. Although investment returns for fiscal year 2011-12 were 1.3 percent compared to 24.6 percent in fiscal year 2010-11, we believe our more diversified asset allocation will set the stage for returns to outpace our industry benchmarks.

The ASRS continues to be engaged in program and policy review and, when appropriate, will again be seeking legislative or other changes to ensure the retirement system operates efficiently and effectively. The ASRS has invested in technology and online solutions to achieve the highest level of service in a cost-efficient environment. We have improved work flows, focused on risk management and collaborated with our employees to nurture staff morale and sustain high levels of member satisfaction.

The ASRS is committed to prudent management of the overall operations and assets of the retirement system for the benefit of our members. At the same time, we are keenly aware of our responsibilities to the State of Arizona, its taxpayers, our members and employer partners.

We appreciate the cooperation extended by the Governor's Office and the State Legislature, which enables and empowers us to meet the challenges we face in today's challenging economic climate.

On behalf of the ASRS staff, we look forward to serving you in the coming years.

Kind regards,

Paul Matson, Director

Executive Staff



Paul Matson
Director



Anthony Guarino
Deputy Director,
Chief Operations Officer



Gary R. Dokes
Chief Investment Officer

PRIDE

OUR VISION

For the benefit of our members...
the Arizona State Retirement System will be a leading state benefit plan administrator in the areas of:

- Core Member Services
- Investment Performance
- Funded Status
- Operational Effectiveness

This will be accomplished while keeping program benefits and associated costs relatively aligned and maintaining actuarial and fiscal integrity.

OUR VALUES

Professionalism.

A highly capable workforce will promote a professional and respectful environment and *lead* the organization.

Results.

A results-oriented approach to operations will *energize* the organization.

Improvement.

A climate of continuous quality improvement and enhanced efficiencies will *drive* the organization.

Diversity.

Engagement of diversity by the appreciation, recognition and support for all people will *propel* the organization to ever greater achievement.

Excellence.

A commitment to service excellence will *permeate* the organization.

Significant New Legislation

Enacted during the fiscal year 2011-2012 legislative session:

- The ASRS Employee and Employer contribution rates are reverted from 53%/47% to 50%/50%, retroactive to July 1, 2011.
- The Level Income Alternative retirement option is eliminated for new retirements after July 1, 2013.
- The requirement that a member must have ten years of credited service before initiating a service purchase is reduced to five years for most service purchase types.
- Married members are required to make certain default beneficiary elections, however a spouse is permitted to consent to an alternative.
- A person who becomes employed after they have reached age 65 and is not active, inactive, retired or disabled, and does not have any credited or prior service in the ASRS, may elect not to participate in the ASRS (before July 1, 2015).
- For new retirees or disabled members, the Health Benefit Supplement will not be paid if the person is covered under an ASRS Employer's "active employee" insurance plan, effective August 2, 2012.
- Disability earnings are capped at 100% of the member's pre-disability salary (the salary ASRS uses in determining benefits) for new disabilities after August 2, 2012.
- The ASRS is required to allocate a liability to an employer that is no longer participating in the ASRS for specifically enumerated reasons, and establishes the liability calculation in statute.
- The ASRS is permitted to determine the method of making disbursements and collecting receipts.
- The ASRS's accounts receivables procedures are enhanced.

AZ 100 YEARS
HISTORY. STILL IN THE MAKING.

Our History

In 1912, Arizona's first year of statehood, the first teacher retired with an Arizona State teacher's pension. From 1912 until 1943, Arizona teachers were granted pensions by the State Legislature if they had at least 30 years of service in Arizona schools and were 65 years of age or older. All teachers' pensions were \$50 per month; there were no member deposits or survivor benefits.

During the late 1930s and early 1940s, there was intense activity to create a formal retirement plan for Arizona teachers. The Legislature created the Teachers' Retirement System, effective July 1, 1943. All certified, full-time teachers were members, contributing to a retirement plan with a fixed benefit formula. The employer contribution rate varied, but could not exceed 5.03 percent of the first \$3,600 of teachers' salaries.

In 1953, the Arizona State Retirement System was created to provide retirement and other benefits for state employees, including university faculty and employees of the state's political subdivisions who signed a membership contract. Active teachers voted to join the ASRS in 1954, and transferred to ASRS on January 1, 1955. The Teachers' Retirement System continued to pay retirement benefits to retired teacher members who were ineligible to join the ASRS.

In 1970, the Legislature agreed to enact the current Arizona State Retirement System Defined Benefit Plan if 70 percent or more of state employees and teachers voted to transfer to the new plan. More than 80 percent of eligible members voted for the new plan, which became effective July 1, 1971. Most political subdivisions have subsequently voted to join.

Today, more than a half-million of Arizona's public servants belong to the ASRS, which encompasses state employees, the three state universities, community college districts, all 15 counties, most cities and towns, school districts and charter schools and other political subdivisions, such as fire and water districts.

Commitment to Service Excellence

The ASRS continually strives for excellence by participating in Pension Administration Benchmarking. The key advantages of benchmarking are:

- Creates a greater openness about strengths and weaknesses
- Engages and motivates staff as they experience change
- Facilitates teamwork and the willingness to adapt to change
- Opens organizations to new methods, ideas and tools to improve both service and cost effectiveness
- Facilitates learning from others and developing and applying new methods and best practices

2012 Member Statistics

Employee Members

Current Employees—Active	214,346
Retirees (including Beneficiaries)	112,306
Non Active	204,203
Long Term Disability Recipients	4,646

Total	535,501
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Did You Know...

The ASRS initiated an online process for members to withdraw their funds and terminate their ASRS membership.

In 2012, 100% of new enrollments were received online.

The ASRS has plans to implement an online process to apply for retirement benefits in 2013.



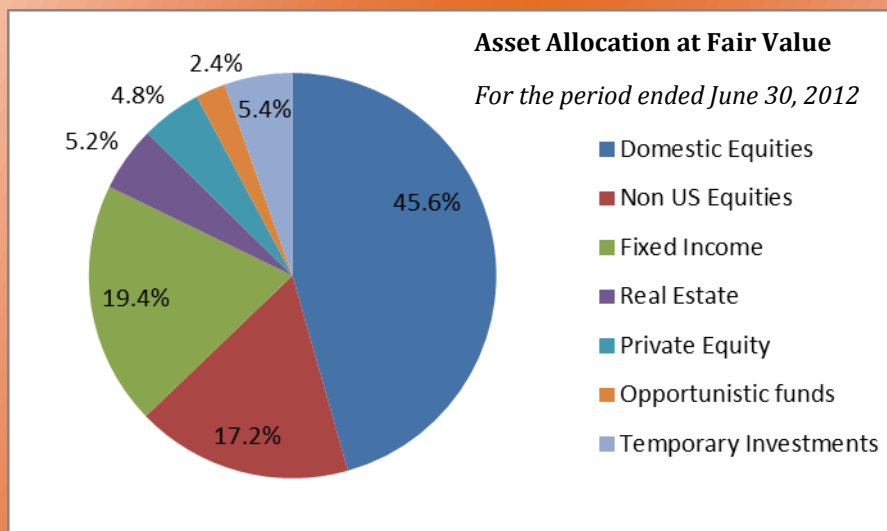
Investments

Results Summary

During fiscal year 2012, ASRS investments were broadly diversified in domestic and international equities, domestic fixed income, real estate, private equity, opportunistic, commodities, and cash equivalent instruments.

At June 30, 2012, the ASRS held net investments of \$27.6 billion. The ASRS portfolio was comprised of \$12.6 billion in domestic equities, \$4.7 billion in international equities, \$5.4 billion in domestic fixed income securities, \$1.4 billion in real estate assets, \$1.3 billion in private equity investments, \$700 million in opportunistic funds, and \$1.5 billion in temporary investments.

For the fiscal year ended June 30, 2012, the ASRS (after fees) rate of return on investments was 1.3 percent, compared to 24.6% for fiscal year 2011. The decrease in the rate of return reflects weak conditions in the global securities market during fiscal year 2012.



Current Market Conditions

The backdrop of slowing global growth in combination with sizeable fiscal deficits present challenges for fiscal and monetary policymakers. U.S. equity markets stalled during FY 2012 due to concerns over slowing growth while the protracted sovereign debt problems in the Euro-zone were a drag on non-U.S. equities. Projections are for slow, but not stellar growth over the next year that will be closely aligned with Federal and stimulus monetary policy. The ASRS continues to implement the Strategic Asset Allocation policy and will allocate assets tactically within guidelines as market opportunities present themselves.

Investment Goals

- Achieve a total fund rate of return equal to or greater than the actuarial assumed interest rate.
- Achieve a total fund rate of return equal to or greater than the asset allocation benchmark.
- Achieve a total fund rate of return equal to or greater than the amount projected in the most recent asset allocation (AA) study.
- Achieve asset class net rates of return equal to or greater than their respective broad asset class benchmarks.
- Achieve portfolio-level net rates of return equal to or greater than their respective portfolio benchmarks.
- Ensure sufficient monies are available to meet cash flow requirements.

Annualized Time Weighted Rates of Return

(After Fees)

(Retirement & Health Benefit Supplement)

	1 Year	3 Year	5 Year	10 Year	Since Inception (June 30, 1975)
ASRS Total Fund	1.3%	13.2%	1.8%	6.3%	9.8%
Benchmark	1.4%	12.6%	1.7%	6.0%	9.5%





Did You Know...

After the establishment of the ASRS on July 1, 1953, non-retired teachers who were members of the Arizona Teachers' Association, had their membership transferred to the ASRS. As a result, the teacher's system, which was established in 1943, became closed to new members.

When the ASRS started in 1953, investments consisted of Government bonds. Today, the ASRS maintains a portfolio consisting of U.S. and non-U.S. equities, real estate, private equity, public equity and opportunistic and commodity investments.

In 1953, the ASRS had five board members. Today there are nine board members.

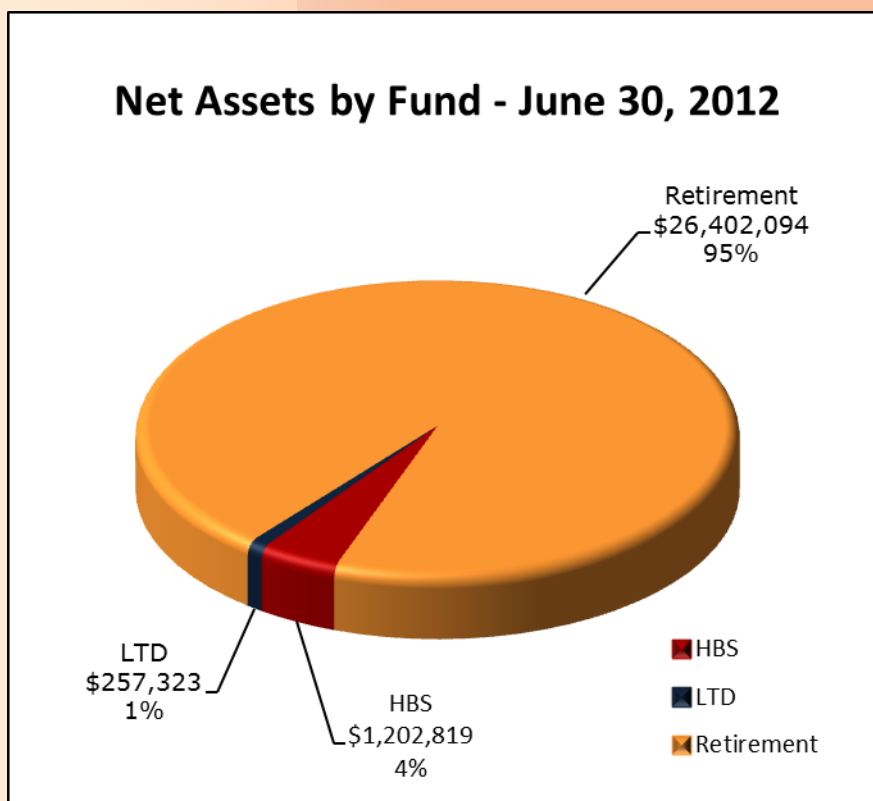
In 1953, there were approximately 5,000 active members and 135 retirees. Today those numbers have grown to more than 204,000 active members and 112,000 retirees.

Financial Summary

The ASRS oversees three funds: Retirement, Health Benefit Supplement, and Long Term Disability. ASRS benefits are funded by member and employer contributions and by earnings on investments. Contributions are distributed according to actuarially determined contribution rates.

The total ASRS net assets held in trust for benefits at June 30, 2012 was \$27.9 billion, a 1.6 percent decrease from the previous fiscal year. The decrease in net assets is primarily due to a decrease in net cash flow from operations, while investment returns of 1.3 percent remained relatively flat. For the 2012 fiscal year employer and member contributions totaled \$1.9 billion. The \$200 million increase over fiscal year 2011 is due to an increase in contribution rates, receipt of funds from the Federal Government for reimbursements related to the Early Retiree Reinsurance Program, and a retrospective health insurance rate adjustment. Deductions from the ASRS net assets held in trust for benefits consist primarily of pension, disability, health insurance and survivor benefits, member refunds and administrative expenses. For the 2012 fiscal year, pension, disability, health insurance and survivor benefits totaled \$2.49 billion, a 6 percent increase over fiscal year 2011, due to an increase in the number of retirees.

The table below shows the net assets by fund as of June 30, 2012:



Statement of Plan Net Assets

Retirement, Health Benefit Supplement and Long Term Disability Funds Combined

Formally referred to as the Statement of Plan Net Assets, the ASRS balance sheet reflects the resources available to pay benefits to members and beneficiaries at the end of the fiscal year. The Statement of Plan Net Assets is presented with a more detailed analysis in the complete ASRS Comprehensive Annual Financial Report.

Statement of Plan Net Assets				
	2012	2011	2010	2009
ASSETS				
Cash, Receivables and Prepays	\$1,092,738	\$1,114,771	\$1,030,361	\$925,271
Investments at Fair Value	27,626,426	28,541,753	23,604,607	21,219,032
Security Lending*	<u>50,070</u>	<u>880,893</u>	<u>2,360,532</u>	<u>3,422,623</u>
Total Assets	28,769,234	30,537,417	26,995,500	25,566,926
LIABILITIES				
Payables and Other Liabilities	856,928	1,341,717	1,242,034	1,143,849
Securities Lending*	<u>50,070</u>	<u>880,893</u>	<u>2,360,532</u>	<u>3,422,623</u>
Total Liabilities	906,998	2,222,610	3,602,566	4,566,472
TOTAL NET ASSETS	\$27,862,236	\$28,314,807	\$23,392,934	\$21,000,454

NOTE: All numbers presented in thousands of dollars.

*The ASRS' custodial bank enters into agreements with borrowers to loan securities and have the same securities redelivered at a later date. Security lending assets represent the cash collateral received from the borrowers that the ASRS has reinvested. Security lending liabilities represent the cash collateral that the ASRS must return to the borrowers upon expiration of the loan. The ASRS receives a spread for its lending activities.

Largest Participating Employers

<u>Participating Employer</u>	<u>Covered Employees</u>
Department of Administration	26,998
Maricopa County	8,992
Mesa Unified District 4	8,466
Tucson Unified District 1	7,087
University of Arizona	7,061
Maricopa County Community College District	6,729
Arizona State University	5,323
Pima County	5,274
Gilbert Unified District 41	4,647
Chandler Unified District 80	4,141
* All Other	129,628
Total	214,346

* In 2012 All Other Consisted of:

<u>Type</u>	<u>Number</u>	<u>Employees</u>
Public Schools	239	87,482
Charter Schools	148	4,691
Cities	80	17,192
Counties	13	8,040
Higher Education	10	5,698
Other	93	6,525
Total Other	583	129,628

Average Benefit Payments

	<u>Annual Amounts</u>
Average Pension	\$19,524
Average Age - Retired	69.7
Average Salary - Active	\$43,365
Average Age - Non-retired	45.7



Budget Savings

During fiscal year 2011-2012, the ASRS planned and implemented strategies to reduce our agency expenditures. As a result, the ASRS realized reductions to the operating budget totaling \$500,000 for FY 2012 and \$3.7 million over the past five years.

Statement of Changes in Plan Net

Retirement, Health Benefit Supplement and Long Term Disability Funds Combined

Formally referred to as the Statement of Changes in Plan Net Assets, the ASRS income statement reflects all the financial activity for the agency for fiscal year ended June 30, 2012. The statement presents information to illustrate how the ASRS' net assets changed during the fiscal year as a result of the financial activity (i.e., contributions, investing activity, expenses). This is a summarized version of the data presented and analyzed in the Comprehensive Annual Financial Report.

	2012	2011	2010	2009
ADDITIONS				
Employee Contributions	\$926,966	\$854,976	\$844,847	\$891,753
Employer Contributions	927,628	859,399	858,431	891,747
Reimbursements	35,473	-	-	-
Service Credit Purchase and Transfers In	53,659	70,812	73,973	72,436
Investment and Security Lending Income (Loss)	475,030	5,833,161	3,144,567	(4,542,158)
Investment and Security Lending Expenses	<u>(136,302)</u>	<u>(128,709)</u>	<u>(116,351)</u>	<u>(131,332)</u>
Total Additions (Reductions)	2,282,454	7,489,639	4,805,467	(2,817,554)
DEDUCTIONS				
Retirement and Disability Benefits	2,457,052	2,324,602	2,188,250	2,042,435
Survivor Benefits	29,731	23,949	26,472	30,378
Refunds and Transfers	212,313	186,975	165,599	126,395
Administration and Other	<u>35,929</u>	<u>32,240</u>	<u>32,666</u>	<u>33,128</u>
Total Deductions	2,735,025	2,567,766	2,412,987	2,232,336
NET CHANGE	(452,571)	4,921,873	2,392,480	(5,049,890)
Net assets beginning of year	28,314,807	23,392,934	21,000,454	26,050,344
Net assets end of year	\$27,862,236	\$28,314,807	\$23,392,934	\$21,000,454

NOTE: All numbers presented in thousands of dollars.

Funding Status and Contribution Rate

Funding Status

Although the ASRS funds are a well-diversified and professionally managed portfolio of investments, significant decreases in the value of the investment portfolio occurred in the fiscal years ended June 30, 2008 and June 30, 2009. These losses will have the effect of reducing the actuarial funded status and the market value funded status of the total plan. As a result, the combined pension and health benefit supplement contribution rate is expected to increase for the next several years.

Contribution Rate

The contribution rate, as determined by the annual actuarial valuation, is designed to ensure that the ASRS fund remains adequate to meet current and future obligations to members. The Arizona Revised Statutes provide statutory authority for determining the employees' and employers' contribution amounts as a percentage of covered payroll. Employees' contributions are applied toward the Retirement and Long Term Disability Plans. Employers' contributions are applied toward the Retirement Plan, Health Insurance Premium Supplement Plan and the LTD Plan. There is no legal or contractual maximum contribution rate for employees or employers.

The actuarially determined contribution rate for the year ended June 30, 2012 was 11.39 percent for members and 10.69 percent for employers. Of the members' total contributions, 11.13 percent was allocated to retirement and 0.26 percent was allocated to long term disability. Of the employers' total contributions, 9.87 percent was allocated to retirement, 0.59 percent was allocated to the health insurance premium supplement and 0.23 percent was allocated to long term disability.*

The actuarially determined contribution rate for the fiscal year 2012-2013 is 11.14 percent for both members and employers. Of the members' total contributions, 10.9 percent is allocated to retirement and 0.24 percent is allocated to long term disability. Of the employers' total contributions, 10.25 percent is allocated to retirement, 0.65 percent is allocated to the health insurance premium supplement and 0.24 percent is allocated to long term disability.

	<u>2013</u>	<u>2012*</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
Retirement Contribution Rates					
Member	10.9	11.13	9.60	9.00	8.95
Employer	10.25	9.87	9.01	8.34	7.99
HBS Contribution Rates					
Employer	0.65	0.59	0.59	0.66	0.96
LTD Contribution Rates					
Member	0.24	0.26	0.25	0.40	0.50
Employer	0.24	0.23	0.25	0.40	0.50

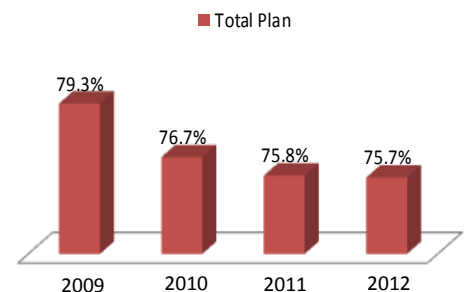
*Subsequent to the completion of the 2012 actuarial valuation, the 50th Arizona State Legislature enacted legislation which retroactively reverted the contribution rate percentage back to 50% for employees and 50% for employers, as of July 1, 2011.

Cost Savings

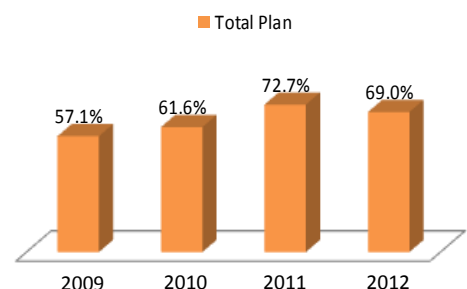
The ASRS has been engaged in significant program and policy review in an effort to reduce costs. While this is an ongoing process, program, policy and legislative initiatives that have been implemented are estimated to have reduced total contributions to the ASRS by approximately \$305 million per year. This is equivalent to approximately \$8.5 billion in liability savings for the group of all current and future employees.

Over the long term, these very significant savings will reduce future increases in contribution rates to both employees and employers by an average of approximately 3.23 percent in total each year.

Actuarial Value Funded Status



Market Value Funded Status



OUTSTANDING ACHIEVEMENT AWARD

Award for Outstanding Achievement in Popular Annual Financial Reporting

PRESENTED TO

**Arizona State
Retirement System**

for the Fiscal Year Ended

June 30, 2011



Christopher P. Morrell
President

Jeffrey L. Esser
Executive Director

The Government Finance Officers Association (GFOA) established this award to acknowledge state and local governments that create high-quality Popular Annual Financial Reports (PAFR). To do this, information must be extracted from the Comprehensive Annual Financial reports to create a PAFR that is easily understandable to the general public and other interested parties who may not have a background in accounting or finance. The report must also be unique and creative and present appropriate financial information accurately in accordance to Generally Accepted Accounting Principles.

The ASRS' PAFR for fiscal year end 2011 received this prestigious award. This PAFR continues to conform to the highest reporting standards and will be submitted to the GFOA Board for review.

Visit the ASRS at: www.azasrs.gov



Delivering Service With Pride

Arizona State Retirement System

A Component Unit of the State of Arizona

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